

Tax Type: Sales Tax
Issue: Sales To Exempt Organization
Reasonable Cause on Application of Penalties

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

V.

**JOHN DOE d/b/a
ABC CATERING**

Taxpayer

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) **Docket No. 99-ST-0000**
) **IBT # 0000-0000**
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Appearances: Jim Day, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Phillip H. Hamilton of Farrell, Hunter, Hamilton & Julian, P.C. for JOHN DOE d/b/a ABC CATERING.

In early 1999, the Department of Revenue (“Department”) conducted an audit of JOHN DOE d/b/a ABC CATERING (“taxpayer”) for the period of May 1, 1989 through December 31, 1998. The taxpayer had not filed timely Sales and Use Tax Returns for the period covered by the audit; in June and July of 1999 he filed returns for the periods covering May 1989 through December 1997. At the conclusion of the audit, the Department issued two Notices of Tax Liability (NTLs) to the taxpayer; he timely protested the NTLs. The taxpayer had also requested that the penalties for the late filing and late payment of the taxes be abated, but his request was denied by the Department. The taxpayer timely protested the denial of the abatement of the

penalties. An evidentiary hearing was held during which the taxpayer presented the following issues: (1) whether certain sales were exempt as sales for resale; (2) whether certain sales were made to exempt entities; and (3) whether the penalties imposed in this case should be abated due to reasonable cause. After reviewing the record, it is recommended that this matter be resolved partially in favor of the taxpayer and partially in favor of the Department.

FINDINGS OF FACT:

1. The taxpayer operates a catering service for social groups and church organizations. He also sells ice to liquor stores, convenient stores, taverns, and restaurants. (Tr. pp. 37, 71)

2. The Department conducted an audit of the taxpayer's business for the period of May 1, 1989 through December 31, 1998. (Dept. Ex. #3, 4)

3. For the audit period, the auditor prepared a list of sales that the taxpayer claimed were tax-free. In order to prepare this list, the auditor used the taxpayer's calendar book and other summaries that were provided by the taxpayer. The summaries were prepared by the taxpayer in response to a request from the Department. The summaries collected information from the calendar book and the taxpayer's ice books. The calendar book did not identify the purchaser, and some of the information on the summaries came from memory. (Tr. pp. 19, 28, 65, 78, 80-81, 87; Taxpayer Ex. #8, pp. 55-66; Taxpayer Ex. #14, 15, 16, 17, 18, 19, 20, 21, 22)

4. The auditor agreed that some of the sales that the taxpayer claimed as tax-free were actually tax-free, and he allowed an exemption for those sales. The taxpayer prepared a list of the remaining sales that he claimed were tax-free (i.e., the ones that the auditor rejected) and presented that list to the Department for its additional review. (Taxpayer Ex. #9A)

5. The Department has stipulated that some of the sales on the taxpayer's list (Ex. #9A) are tax-free sales and has indicated which of those sales should be exempt on Taxpayer Ex. #9B. (Tr. pp. 27, 78-79; Taxpayer Ex. #9B)

6. The remaining sales on Taxpayer Ex. #9B that the Department has not agreed are tax-free include sales of ice that the taxpayer contends were sold for resale, sales to organizations that the taxpayer claims were exempt organizations, and sales to out-of-state purchasers. (Taxpayer Ex. #9B)

7. The taxpayer has not raised an issue concerning the out-of-state sales and did not present any documentary evidence concerning the out-of-state sales.

8. The taxpayer presented a sample of his invoices concerning sales of ice. The names of some of the customers on the invoices are not clearly discernible. It is not clear which ice sales were to liquor stores, convenient stores, taverns, or restaurants. (Tr. pp. 72-74; Taxpayer Ex. #34)

9. The taxpayer has never remitted retailers' occupation tax on his sales of ice. (Tr. p. 71)

10. The taxpayer presented Certificates of Resale from some of his ice customers. The taxpayer did not provide the amount of the sales to these customers. (Taxpayer Ex. #24)

11. The taxpayer's catering customers include Rotary Clubs, service organizations, schools, and churches. (Tr. p. 75)

12. The taxpayer presented exemption numbers for certain entities that purchased catering services during the audit period. Taxpayer Ex. #9C is similar to Ex. #9B, except that Ex. #9C includes the additional exemption numbers provided by the taxpayer. The sales on Taxpayer Ex. #9C that are marked with an "OK" or have an exemption number next to them are

the sales for which the taxpayer is entitled to an exemption from the tax. (Tr. pp. 79-80; Taxpayer Ex. #9C; 23)

13. While conducting the audit, the auditor issued a Form EDA-11B, which is a Notice of Demand for Documentary Evidence that requires the taxpayer to provide the Department with information supporting the non-taxable nature of his transactions within 60 days from the date of the Notice. The auditor also issued a Form EDA-11A, which is a similar notice that demands the taxpayer's books and records. The taxpayer did not provide the auditor with documents, invoices or ledgers in response to the Forms EDA-11A and B. (Tr. p. 20; Dept. Ex. #5)

14. In November of 1993, the taxpayer suffered a stroke. As a result of the stroke, the taxpayer lost the use of his right arm, but has regained most of the strength in it. He still has difficulty going down steps. (Tr. p. 41)

15. In 1998, the taxpayer was diagnosed with colon cancer and underwent chemotherapy for 10 months. He was hospitalized for the cancer for one week. His cancer is currently in remission. (Tr. pp. 42, 62)

16. In August of 1998 the taxpayer underwent brain surgery for a cholesteatoma of the left ear. The taxpayer has had a life-long history of chronic otitis media. The taxpayer still has difficulty hearing, and his hearing cannot be corrected with a hearing aid. He must have his ears cleaned two or three times a year. (Tr. pp. 42-45; 48)

17. The taxpayer was never in the hospital for a period longer than one week. (Tr. p. 62)

18. The taxpayer has been in the catering business approximately 20 years. Prior to the sole proprietorship, the taxpayer operated a business known as ABC CATERING, Inc. The corporation was dissolved in 1989 when the taxpayer received a divorce. The corporation was registered with the Department and filed and paid sales taxes. (Tr. pp. 51-52)

19. In 1989 or 1990, the taxpayer obtained a city license for his current business. (Tr. p. 53)

20. At the outset of the sole proprietorship, the taxpayer cooked the food and transported it to where it was going to be served. He sometimes took orders from the customers and ordered supplies for the business. He collected money from his customers and paid his creditors. (Tr. pp. 56-57)

21. The taxpayer was involved in the production of ice and the delivery of the bags of ice to his customers. (Tr. p. 58)

22. The taxpayer's current wife has assisted the taxpayer with his business since 1989 and married him in 1994. She helped him respond to the Department's audit. (Tr. pp. 84-85, 88)

23. The taxpayer did not timely file Sales and Use Tax Returns during the audit period. In June 1999, the taxpayer filed Sales and Use Tax Returns for January 1990 through December 1997. (Tr. p. 54; Taxpayer Ex. #11, 12)

24. In July 1999, the taxpayer filed Sales and Use Tax Returns for May 1989 through December 1989. (Taxpayer Ex. #10)

25. On December 30, 1999 and January 14, 2000, the Department issued Notices of Tax Liability that assessed additional tax, penalties, and interest as a result of the audit. The Notices were admitted into evidence under the certificate of the Director of the Department. (Dept. Ex. #3, 4)

CONCLUSIONS OF LAW:

The Retailers' Occupation Tax Act ("ROTA") (35 ILCS 120/1 *et seq.*) imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2. Section 4 of the ROTA provides that the certified copy of the notice of tax liability issued by the

Department "shall be prima facie proof of the correctness of the amount of tax due, as shown therein." 35 ILCS 120/4. Once the Department has established its *prima facie* case by submitting the notice into evidence, the burden shifts to the taxpayer to overcome this presumption of validity. A.R. Barnes & Co. v. Department of Revenue, 173 Ill.App.3d 826, 832 (1st Dist. 1988). To prove his case, a taxpayer must present more than his testimony denying the accuracy of the Department's assessment. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill.App.3d 203, 217 (1st Dist. 1991). The taxpayer must present sufficient documentary evidence to support his claim. Id.

The taxpayer's initial argument is that he does not owe retailers' occupation taxes on his sales of ice because they were all sales for resale. Section 2c of the ROTA concerns sales for resale and provides in part as follows:

"[A] sale shall be made tax-free on the ground of being a sale for resale if the purchaser has an active registration number or resale number from the Department and furnishes that number to the seller in connection with certifying to the seller that any sale to such purchaser is nontaxable because of being a sale for resale.

Failure to present an active registration number or resale number and a certification to the seller that a sale is for resale creates a presumption that a sale is not for resale. This presumption may be rebutted by other evidence that all of the seller's sales are sales for resale, or that a particular sale is a sale for resale." 35 ILCS 102/2c.

The taxpayer has provided Certificates of Resale that he obtained from some of his ice customers. He acquired these certificates during the audit and was unable to obtain certificates from all of his customers because some of them were out of business. The taxpayer contends that because he never made any sales of ice at retail and because he has receipt books that document the sales at resale, all of his ice sales should be exempt.

Although the taxpayer did not collect tax on the sales of ice, he must present sufficient evidence indicating that either all of his sales are for resale or a particular sale is a sale for resale. The evidence does not support a finding that all of his ice sales were for resale. The taxpayer sells bags of ice to liquor stores, convenient stores, taverns, restaurants, and drug stores. (Tr. p.

71) The sales to liquor stores, convenient stores, and drug stores are likely sales for resale because those businesses generally sell the bags of ice and collect tax on their sale. Restaurants and taverns, however, generally do not sell bags of ice but, rather, they use the ice in their businesses. Because some of the taxpayer's sales of ice were to taverns and restaurants where the ice was likely used as part of the business, it cannot be found that all of the taxpayer's sales of ice were for resale.

The evidence also does not support a finding that a particular sale was a sale for resale. The invoices in the sample receipt book provided by the taxpayer for his ice sales do not have clearly discernible names of the purchasers. It cannot be determined which of those sales were to liquor stores or to convenient stores. Although the taxpayer presented Certificates of Resale from some of his ice customers, nothing in the record identifies the amount of the sales to those specific customers. None of the documents presented by the taxpayer separately identifies the ice customers and the amount of their purchases. The taxpayer has the burden of proving that a particular sale is a sale for resale, and he has failed to meet that burden.

With respect to the sales to exempt organizations, the taxpayer has presented exemption numbers for some of these entities. The sales listed on Taxpayer Ex. #9C that are marked with an "OK" or have an exemption number next to them are the sales for which the taxpayer has provided an exemption number. The taxpayer is entitled to an exemption from the tax for these sales.

Finally, the taxpayer has asked that the penalties be abated. The penalties may be abated if the taxpayer shows that the failure to file the returns or pay the taxes was due to "reasonable cause." (35 ILCS 735/3-8) The most important factor to consider in determining whether to abate the penalties is the extent to which the taxpayer made a good faith effort to determine his

proper tax liability and to file and pay his proper liability in a timely fashion. (See 86 Ill.Admin.Code, ch. 1, §700.400(b)) The Department's regulation concerning reasonable cause provides examples and states that reasonable cause may be based on the death, incapacity or serious illness of the taxpayer (or his tax preparer). It may also be based on a death or serious illness in his or her immediate family that causes a late filing and payment of the tax due. (See 86 Ill.Admin.Code, ch. 1, §700.400(e)(2))

In the present case, the taxpayer did not file returns for the nine-and-a-half-year audit period until he was audited. The taxpayer explained that he did not register his business with the Department and did not timely file his returns because he was taking care of his parents, who were very ill, and he neglected his business. The taxpayer further stated that the illnesses that he suffered from were a distraction and interfered with his ability to register his business. Although the taxpayer has suffered from chronic otitis media all his life, he was able to register his corporation with the Department prior to establishing his sole proprietorship, and he was able to obtain a city license for his current business. Once his sole proprietorship was started, he cooked the food, transported it to his customers, took orders, collected money, and paid the bills. He also bagged and delivered ice to his customers. Despite his illnesses, he was able to maintain his business. Even though his current wife has worked for him since the beginning of the sole proprietorship, he did not seek her assistance in attempting to file and pay his taxes. While the taxpayer's illnesses warrant much sympathy, the record does not reveal a good faith attempt during nine-and-a-half years to file or pay the retailers' occupation taxes. These facts do not support abating the penalty.

Recommendation:

For the foregoing reasons, it is recommended that the taxpayer is entitled to an exemption from the tax for the sales listed on Taxpayer Ex. #9C that are marked with an “OK” or have an exemption number next to them. It is further recommended that the ice sales are not exempt as sales for resale and the penalties should not be abated.

Linda Olivero
Administrative Law Judge

Enter: May 10, 2002